



Farrell Fritz Client Advisory: Say-on-Pay & Say-on-Frequency Voting in the 2011 Proxy Season

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Background

On January 25, 2011, the SEC announced it had adopted final rules concerning Say-on-Pay, Say-on-Frequency and "golden parachute" compensation arrangements (the "Rules"). The Rules are required by a new section 14A(a) of the Securities Exchange Act of 1934, which was adopted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Pursuant to the Rules, for annual meetings held on or after January 21, 2011, most domestic public companies will be required to

- Submit "named executive officer compensation" to a non-binding Say-on-Pay vote at least once every three calendar years, and
- Take a non-binding shareholder vote on the frequency of the Say-on-Pay vote. The Say-on-Frequency must be taken at least once every six years.

The SEC also adopted a temporary exemption for companies with public float of less than \$75 million. These smaller companies will not be required to conduct Say-on-Pay and Say-on-Frequency votes until annual meetings occurring on or after Jan. 21, 2013. There is no temporary exemption for smaller reporting companies in connection with the shareholder advisory vote on golden parachute compensation.

Say-on-Pay

Say-on-Pay votes relate to the compensation of a company's named executive officers. Because it is an advisory vote, the outcome does not affect compensation decisions made by the compensation committee or board of directors. The Say-on-Pay vote must be included in proxy statements for annual or other meetings of shareholders for which proxies are solicited for the election of directors. The vote must apply to all executive compensation required to be disclosed in the proxy statement, including the Compensation Discussion and Analysis (CD&A) and narrative and tabular disclosure. The vote cannot be limited so as to apply only to certain elements of compensation, such as the company's compensation policies. The proposal is not required to cover director compensation, practices relating to risk management, or risk-taking incentives generally relating to company employees. However, to the extent that risk considerations are discussed in the CD&A because they are a material component of executive compensation policies or determinations, those risk considerations would be considered by shareholders in connection with the Say-on-Pay proposal.

Although the Say-on-Pay proposal is not required to contain any specific language or format, the Rules require that the disclosure state that the Say-on-Pay proposal is being submitted to shareholders because it is required under

Section 14A of the Exchange Act and briefly explain the effect of the shareholder vote, such as that the vote is non-binding.¹

The Rules require that future CD&A disclosure address whether, and if so how, the company's decisions regarding compensation and compensation policies have taken into account the results of the most recent Say-on-Pay vote. However, the SEC has stated that companies (other than smaller reporting companies) should address their consideration of the results of earlier Say-on-Pay votes to the extent such consideration is material to the compensation policies and decisions discussed in the CD&A. The Rules do not change the scaled disclosure requirements for smaller reporting companies, and these companies will not be required to provide a CD&A.

Say-on-Frequency

Starting with a company's first shareholder meeting held on or after January 21, 2011, it also must submit a Say-on-Frequency proposal for a shareholder vote at least once every six years. The proposal is a non-binding, advisory vote that allows shareholders to vote on how frequently a Say-on-Pay proposal will be submitted for a shareholder vote - every year, every second year or every third year.

As with Say-on-Pay, the Rules do not require that the Say-on-Frequency proposal use any specific language. The disclosure is required to make it clear, however, that shareholders have a choice among four alternatives for the frequency of Say-on-Pay votes - annual, biennial, triennial and abstain from voting. As required for Say-on-Pay, the Say-on-Frequency disclosure must state that the proposal is being submitted to shareholders as required by Section 14A of the Exchange Act and explain the effect of the shareholder vote, including that the vote is non-binding.

Following the Say-on-Frequency vote, the company must disclose in a Form 8-K how often it will hold the Say-on-Pay vote. An issuer must also provide disclosure in its proxy materials of the current frequency of its Say-on-Pay votes and when the next scheduled Say-on-Pay vote will occur.

No board recommendation is required in connection with the proposal. Companies and their boards of directors must decide if they will make a recommendation to shareholders regarding the frequency of the Say-on-Pay vote and, if so, what that recommendation will be. In making that decision, boards of directors may want to consider, among other things:

- any policy on Say-on-Frequency adopted by their institutional shareholders,
- that proxy advisory firms, such as Glass-Lewis and ISS, have recommended an annual Say-on-Frequency vote²,

¹ The Rules provide a non-exclusive example that would satisfy Rule 14a-21(a), as follows: “RESOLVED, that the compensation paid to the company’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby APPROVED.”

² Neither ISS nor Glass-Lewis has stated that it would recommend a “withhold” vote for directors on a board that does not recommend, or subsequently adopt, an annual Frequency Vote. However, we believe that, in the future, proxy advisory firms are likely to recommend a “withhold” vote for the members of any board that does not adopt a frequency policy consistent with the choice selected by a majority, or perhaps plurality, of the votes cast.

- any recommended frequency proposed by peer companies, and
- any desire to have the Say-on-Pay vote align with their company's compensation programs.

A company may vote uninstructed proxy cards in accordance with management's recommendation for the Say-on-Frequency vote if the company follows requirements to (1) include a recommendation for the frequency of Say-on-Pay votes in the proxy statement, (2) permit abstention on the proxy card, and (3) include language in bold on the proxy card regarding how uninstructed shares will be voted.

The Rules do not provide a specific standard for determining how a frequency choice "wins" - by receiving a plurality, majority or super-majority vote - but if the company adopts a frequency policy consistent with the choice selected by a majority of the votes cast, then it may exclude any future shareholder proposals seeking a more-frequent (or less-frequent) Say-on-Pay vote.

Golden Parachute Arrangements

Companies are required to provide additional disclosure regarding compensation arrangements with executive officers in connection with merger and certain other transactions, known as "golden parachute" arrangements. Narrative and tabular disclosure are required of all agreements and understandings that the acquiring and target companies have with the named executive officers of both companies.

The Rules require that companies provide a separate shareholder advisory vote to approve certain "golden parachute" compensation arrangements in connection with a merger (including going-private transactions and third-party tender offers), acquisition, consolidation, proposed sale or other disposition of all or substantially all assets, so that the information is available for shareholders regardless of the transaction's structure. The separate vote is required unless such agreements or understandings have been subject to the periodic Say-on-Pay shareholder vote. Companies are required to comply with the golden parachute compensation shareholder advisory vote and disclosure requirements in proxy statements and other schedules and forms initially filed on or after April 25, 2011.

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